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SUBJECT: GENEROUS 2007 GOI BUDGET HAS 2007 ELECTIONS IN MIND

¶1. On December 6, Finance Minister Brian Cowen presented the Irish Government's budget for 2007, a generous package of tax cuts and social spending increases that will likely enhance the appeal of the governing Fianna Fail party ahead of Ireland's 2007 general elections. The budget included benefits for every segment of society, including: hikes in social welfare payments for those in difficult economic circumstances; increased state pensions for the elderly; higher children's allowance payments for families; and, mortgage interest tax credits for first-time home buyers. Regarding tax cuts, the Government raised the income threshold at which workers begin to pay taxes and also brought down the top personal income tax rate from 42 to 41 percent -- with a promised additional 1 percent cut next year if Fianna Fail is reelected. In crafting the budget, Minister Cowen had the benefit of tax revenues for 2006 that outstripped initial estimates by nearly euro 4 billion, as well as projected robust economic growth of over 5 percent in ¶2007. Even with the planned 11.5 percent increase in government spending in 2007, the Government expects to run a budget surplus of 1.2 percent of GDP.

¶2. Comment: The danger is that the fiscal stimulus contained in the 2007 budget may be excessive for an already buoyant economy that saw inflation increase to over 3 percent this past year. A further danger is that the Special Savings Incentive Accounts (SSIAs, five-year private savings accounts initiated in 2001-2002 with government matching contributions) have begun to mature, making roughly euro 12 billion available to the accounts' holders and potentially adding to inflationary pressures. Minister Cowen, however, has dismissed concerns about economic overheating, and political opposition parties have focused their criticism not on the budget's possible expansionary effects, but rather on the potential for ECB interest rate hikes to erode budgetary benefits. For example, opposition politicians claim that the ECB's 0.25 percent interest rate hike on December 7 and expected further ECB hikes will cancel out the mortgage interest tax credits that the budget offered first-time home buyers. Notwithstanding the opposition's criticism, the Irish media has reported an enthusiastic public reception for the budget, a good omen for Fianna Fail's 2007 electoral prospects.

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